FILE COPY

Office - Supreme Court, U. S.
FILED
OCT 16 1937
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1937.

No. 27

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

v.

H. C. GOWRAN,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF FOR RESPONDENT.

A. L. NASH,
Attorney for Respondent,
Manitowoc Savings Bank Bldg.,
Manitowoc, Wisconsin.

A. L. NASH,
JOHN C. ALTMAN,
Of Counsel.

THE GUNTHORP-WARREN PRINTING COMPANY, 330 WEST JACKSON, CHICAGO

SUBJECT INDEX.

	PAGE
Opinions Below	1
Jurisdiction	1
Questions Presented	2
Statutes and Regulations Involved	3
Statement of the Case	3
Summary of Argument	9
Argument	12
Divisions of Argument:	
Point I—All stock dividends are exempt from taxation under Section 115(f) of the Revenue Act of 1928	12
Point II—The stock dividend in this case, paid by the company in its own preferred stock to holders of common, did not constitute income of the respondent under the Sixteenth Amendment	25
Point III—The cost-basis, so called, of the stock dividend in this case was the fair market value of the stock when received by the taxpayer	31
Point IV—The question of the correct cost basis of the dividend stock was not properly raised in the court below	37
Point V—The Commissioner's contention that this case should now be remanded to the Board of Tax Appeals, for a new hearing and new determination with respect to the application of Section 115(g) of the Revenue Act of 1928, should be overruled	41
Conclusion—The Decision of the Circuit Court of Appeals should be affirmed	45
Appendix	47

TABLE OF AUTHORITIES CITED.

Cases.

Ana Maria Sugar Company, Inc. v. Quinones, 254 U. S. 245, 251 45
Bank of Arizona v. Thomas Haverty Co., 232 U. S. 106, 110 45
Bankers Trust Co. v. Commissioner, 24 B. T. A. 10... 34
Bowers v. N. Y. & A. Lighterage Co., 273 U. S. 346... 19
Brewster v. Gage, 280 U. S. 327, 337..... 23
Burnet v. Commonwealth Imp. Co., 287 U. S. 415, 418. 45
Burnet v. Niagara Falls Brewing Co., 282 U. S. 648... 19
Clark v. Commissioner, 28 B. T. A. 1225, aff'd 77 Fed. (2d) 89 (C. C. A. 3rd)..... 28
Crooks v. Harrelson, 282 U. S. 55, 59, 61.....17, 18, 19
De Ganay v. Lederer, 250 U. S. 376..... 19
Eisner v. Macomber, 252 U. S. 189, 199, 201.....
.....12, 13, 14, 15, 16, 19, 21, 22, 24, 25, 28, 29
Elmhurst Cemetery Co. v. Commissioner, Law ed. Advance Opinions, Vol. 81, p. 300..... 44
Francis Francis v. Commissioner, 15 B. T. A. 1332..... 34
General Utilities & Operating Company v. Helvering, 296 U. S. 200, 206..... 38
Gibbons v. Mahon, 136 U. S. 549.....15, 16
Gould v. Gould, 245 U. S. 151..... 19
Gowran v. Commissioner, 32 B. T. A. 820, 87 Fed. (2d) 125, 127, 128.....8, 35
Gray v. Hemenway, 212 Mass. 239; 98 N. E. 789..... 14
Hartley v. Commissioner, 295 U. S. 216, 218, 219..... 33

Heiner v. Tindle, 276 U. S. 582, 585, 586.....35, 36
Helvering v. City Bank Farmers Trust Co., 296 U. S. 85 17
Helvering v. Minnesota Tea Co., 296 U. S. 378, 380... 45
Helvering v. Montana Life Insurance Company, 84 Fed. (2d) 623..... 39
Helvering v. Rankin, 295 U. S. 123, 131..... 44
Helvering v. Salvage, 297 U. S. 106, 109..... 38
Helvering v. Tex-Penn Oil Co., Law ed., Advance Opinions, Vol. 81, pp. 538, 539..... 44
August Horrmann, 34 B. T. A. 1178..... 13
Koshland v. Helvering, 298 U. S. 441, 444, 445, 446.....12, 13, 15, 16, 19, 20, 22, 25, 27, 36
Langnes v. Green, 282 U. S. 531..... 40
Lucas v. Daniel, 45 Fed. (2d) 58, 60..... 35
Magruder v. Drury, 235 U. S. 106, 113..... 45
Massachusetts Mutual L. Ins. Co. v. United States, 288 U. S. 269, 273..... 23
McCaughn v. Hershey Chocolate Co., 283 U. S. 488, 492, 493..... 23
Murphy Oil Co. v. Burnet, 287 U. S. 299, 302, 303..... 23
National Lead Co. v. U. S. 252 U. S. 140, 146, 147..... 23
Old Colony R. R. Co. v. Comm., 284 U. S. 552, 560, 561.. 19
Old Mission Portland Cement Co. v. Helvering, 293 U. S. 289, 293, 294..... 23
Pacific States Box & Basket Co. v. White, 296 U. S. 176, 186..... 45
Pfeiffer v. Commissioner, 88 Fed. (2d) 3.....8, 13, 29, 39
Stelos v. Hosiery Corp., 295 U. S. 237.....40, 41
Sunset Scavenger Co. v. Commissioner, 84 Fed. (2d) 453..... 39

Tillotson Mfg. Co. v. Commissioner, 27 B. T. A. 913, aff'd 76 Fed. (2d) 189 (C. C. A. 6th) 3, 4, 6, 7, 25, 28, 42, 43

Towne v. Eisner, 245 U. S. 418, 424, 426 ..... 16, 30

United States v. American Railway Express Co., 265 U. S. 425 ..... 40, 41

United States v. Cercedo Hermanos y Compania, 209 U. S. 337, 339 22

United States v. Dakota-Montana Oil Co., 288 U. S. 459, 466 23

United States v. Merriam, 263 U. S. 179 19

United States v. Missouri Pacific R. R. Co., 278 U. S. 269, 277 17

United States v. Updike, 281 U. S. 489 19

Van Camp & Sons Co. v. American Can Co., 278 U. S. 245, 253 17

Ward v. Commissioner, 29 B. T. A. 1251 34

Weiss v. Stearn, 265 U. S. 242, 253 16

White River Lumber Co. v. State ex rel. Applegate, 279 U. S. 692, 700 45

STATUTES.

Revenue Act of 1916, c. 463, 39 Stat. 756, Sec. (2) (a) ... 14

Revenue Act of 1918, 40 Stat. 1057, Sec. 402 17

Revenue Act of 1921, c. 136, 42 Stat. 227, Sec. 201(d) ... 13, 15, 22

Revenue Act of 1924, 43 Stat. 253:

Sec. 201(f) 15

Sec. 906(d) as amended by Sec. 1000 of the Revenue Act of 1926, 44 Stat. 9 3

Revenue Act of 1926, 44 Stat. 9, Sec. 201(f) 15, 28

Revenue Act of 1928, c. 852, 45 Stat. 791:
Sec. 113 ..... 32, 36, 47
Sec. 115 2,
5, 6, 7, 8, 9, 11, 12, 15, 20, 21, 22, 24, 31, 37, 41, 43, 44, 48
Sec. 601 ..... 42, 49
Revenue Act of 1932, 47 Stat. 169, Sec. 115(f) 15
Revenue Act of 1934, 48 Stat. 680, Sec. 115(f) 15
Revenue Act of 1936, 49 Stat. 1648, Sec. 115(f) 15, 20

TREASURY REGULATIONS.

Article 1562 of Regulations 45 (1918) 34
Articles 1545 and 1547 of Regulations 45 (1918) 21
Article 58 of Regulations 74 (1928) 5, 37, 50
Article 600 of Regulations 74 (1928) 5, 37, 50
Article 628 of Regulations 74 (1928) 50
Article 629 of Regulations 74 (1928) 43

TREASURY DECISIONS.

No. 3052, 3 C. B. 38 (1920) 21, 51
No. 3059, 3 C. B. 38 (1920) 16, 21, 51
Office Decision 732, 3 C. B. 39 21
Office Decision 801, 4 C. B. 24 ..... 22, 51

MISCELLANEOUS.

14 Corpus Juris 812 14
2 Clark & Marshall, Private Corporations, Sec. 523e, p. 1601 14
Thompson on Corporations, Vol. 7, 3rd Ed., p. 137 14
Cong. Rec. (1936), p. 6214 24
Cong. Rec. (1936), p. 6309 24

IN THE

Supreme Court of the United States

OCTOBER TERM, 1937.

No. 27.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

H. C. GOWRAN,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF FOR RESPONDENT.

OPINIONS BELOW.

The opinion of the Board of Tax Appeals in this case (R. 30) is reported in 32 B. T. A. 820. The opinion of the Circuit Court of Appeals for the Seventh Circuit (R. 56) is reported in 87 Fed. (2d) 125.

JURISDICTION.

The statutory basis of the jurisdiction of this court is that which is asserted by petitioner. The judgment of the Circuit Court of Appeals (R. 60) was entered December 22,

1936. The Commissioner of Internal Revenue, petitioner in this court but respondent in the Circuit Court of Appeals, petitioned in due course for rehearing (R. 60), and the Circuit Court of Appeals denied that petition on January 12, 1937 (R. 60). The Commissioner then filed in this court his petition for certiorari, which petition was granted on May 17, 1937 (R. 61).

Questions Presented.

I. Whether a stock dividend, distributed by a corporation in its own preferred stock to holders of common stock, is subject to tax under Section 115(f) of the Revenue Act of 1928.

II. Whether such a stock dividend, paid in preferred stock on common, is income under the Sixteenth Amendment to the Constitution.

III. Assuming that such stock dividend does not constitute taxable income at the time of its receipt, what is the correct cost basis of the dividend stock,—its market value, or zero?

IV. Was the question of the correct cost basis of the dividend stock properly raised in the court below?

V. In the event that this court should hold that the stock dividend in question was not taxable at the time of its receipt and the cost basis of the dividend stock under the circumstances is not zero, the Government raises this further question: whether the case should be remanded to the Board of Tax Appeals for further hearing with respect to the application of Section 115(g), dealing with the redemption of stock under such circumstances that it should be treated as equivalent to the distribution of a taxable dividend.

Statutes and Regulations Involved.

The statutes and regulations involved in the instant case will be found in the Appendix, *infra*, pp. 47-51.

Statement of the Case.

The Commissioner asserted a deficiency in the Federal income tax of the respondent taxpayer for the year 1929. The taxpayer refused to admit such deficiency. The Commissioner's claim and the taxpayer's denial of it constitute the controversy involved in the case.

The statement of facts contained in the Commissioner's brief is incomplete, and in some respects is inaccurate. One thing in particular requires comment; the Commissioner's brief asserts that the first decision of the Board of Tax Appeals, in the form of the report of a division of the Board, was *reviewed* by the Board and therefore ceased to have any effect. The fact is that the division of the Board which conducted the hearing and heard the testimony made a report in favor of the respondent taxpayer, holding that there was no deficiency (R. 14-21); that the Commissioner moved for review by the Board under the provisions of Section 906(d) of the Revenue Act of 1924 as amended by Section 1000 of the Revenue Act of 1926 (R. 22); and that this motion for review was denied (R. 25). The issue as tried out before the Board of Tax Appeals, and thus disposed of, was the issue joined by the pleadings before the Board. A new and entirely different issue was raised by the Commissioner's motion for reconsideration. In urging reconsideration, the Commissioner did not challenge the correctness of the first decision in favor of the taxpayer, based as it was on the facts and circumstances proved without dispute at the hearing, but cited the Board's decision in *Tillotson Mfg. Co.* v. *Commissioner*, 27 B. T. A. 913, and urged that the rule of that case ought to be followed, and

that the result would be a deficiency against the taxpayer on a new theory of tax liability (R. 22-25). On reconsideration, the Board followed precisely the Commissioner's argument, held that the instant case was ruled by the *Tillotson* case, and adjudged a deficiency without changing or reviewing the original decision in favor of the taxpayer on the issue presented by the pleadings (R. 31-35).

For the purpose of correcting and supplementing the statement of facts in the Commissioner's brief, the respondent taxpayer states that the company which distributed the stock dividend in question, Hamilton Manufacturing Company, had in 1929 two classes of stock: common stock without par value and preferred stock with a par value of $100 per share (R. 9). The preferred stock was non-voting, even in the event of default in payment of its dividends, and carried a preferential annual dividend limited to seven per cent., payable only out of profits (R. 9-10). The common stock carried full voting rights, one vote per share, and was entitled to unlimited dividends after payment of all accrued dividends on preferred stock, and entitled also to all of the assets of the company on liquidation after payment of the par value of outstanding preferred stock (R. 9-10).

Prior to the distribution of the stock dividend on July 1, 1929, the company's issued preferred stock and issued common stock stood at the amounts stated in the Commissioner's brief, respondent taxpayer being then a holder of common stock but not of preferred (R. 11). The dividend was distributed on July 1, 1929, in the form of preferred shares to holders of common, and respondent taxpayer received in this way 533 shares of preferred stock (fractional shares omitted), being the proportionate amount of the dividend shares due him on account of his common shares previously owned (R. 13-33). While the case was pending before the Board of Tax Appeals, it was stipulated that the fair market value of these preferred shares, at the date of

the stock dividend, was the same as their par value, to-wit: $100 per share (R. 30).

A few months later the taxpayer sold his dividend shares back to the company at $100 per share (R. 31-33). This sale by the taxpayer to the company was the result of a special arrangement between the company and four of its thirty common stockholders, whereby the company purchased the dividend stock for resale to its employees (R. 19; R. 33). On the hearing before the Board, evidence was taken relative to this purchase of stock by the company, and the decision (R. 14-21) embodied findings as to the reasons and circumstances and the conclusion that there had been no redemption or cancellation of the taxpayer's dividend stock at a time and in the manner that would make the distribution and cancellation or redemption essentially equivalent to the distribution of a taxable dividend under the provisions of Section 115(g) of the Revenue Act of 1928. In fact, the decision held that there had been no redemption or cancellation at all. Since there was no dispute as to the facts, the evidence was not printed in the record. A stipulation covering most of the facts was entered into at the Board hearing and is in the record (R. 8-13), and this, together with matters set forth in the several opinions promulgated by the Board, embody all the facts that it is necessary to have before the court for the determination of the points of law involved.

In making his return of 1929 income, the taxpayer reported $47,161.62 of capital net gain, which included $27,262.72 as capital net gain on the sale of his dividend shares (R. 6). The latter figure was computed under Treasury Regulations then in force (Articles 58 and 600, Regulations 74), by spreading the cost of the taxpayer's original shares between the total number of original and dividend shares held after the dividend, and from the cost basis of the dividend shares so obtained computing the profit per

share on a sale at $100. The Commissioner, by his deficiency letter, eliminated from gross income the $27,262.72 of capital net gain on the taxpayer's sale of dividend shares, but added back the entire par value of the dividend shares, $53,371.50 (R. 6-7). The sole ground asserted by the Commissioner for thus increasing the taxpayer's taxable income was that "the redemption of the stock by the corporation is essentially equivalent to the distribution of a taxable dividend", under the provisions of Section 115(g) of the Revenue Act of 1928 (Commissioner's deficiency letter, admitted by the pleadings to have been sent to the taxpayer; (R. 6 and 7).

The taxpayer in due course petitioned the Board of Tax Appeals for redetermination of the deficiency, the pleadings raising the single issue based on Section 115(g) of the 1928 Revenue Act. On that issue the decision went in favor of the taxpayer, as indicated above. Thereafter the Board granted reconsideration, and, with two members dissenting, made a decision which may be summarized as follows: the Commissioner determined that there had been a redemption of dividend shares in such a manner as to make the transaction essentially equivalent to the distribution of a taxable dividend under Section 115(g) of the Revenue Act of 1928; the taxpayer assigned error in such determination, and "the Board, in its memorandum opinion heretofore entered, considered the proceedings only on the basis of such assigned error and determined, upon the facts, that the preferred stock was not redeemed in 1929 in such a manner as to make the distribution essentially equivalent to the distribution of a taxable dividend"; the parties did not raise nor did the Board consider the question of whether the dividend was tax-free when the shares were issued on July 1, 1929 (R. 31); in the *Tillotson* case the Board had held that the distribution of a stock dividend in common shares to holders of preferred resulted

in such a change of interest as to produce income (R. 33, 34); the rule of the *Tillotson* case must control the instant case, although the dividend here was in preferred shares on common (R. 34); and "the disputed dividend • • • of a fair market value of $1[illegible] per shares, when issued on July 1, 1929, was not a tax[illegible]ree stock dividend" (R. 35). It should be noted that this second decision of the Board stated that the Board (not merely a division of the Board) had determined, *upon the facts*, that the preferred stock was not redeemed in such a manner as to make the transaction equivalent to the distribution of a taxable dividend, but that nevertheless a deficiency judgment must go against the taxpayer under the rule of the *Tillotson* case.

The taxpayer appealed to the Circuit Court of Appeals for the Seventh Circuit. There counsel for the Government argued that the fair market value of the stock received by the respondent taxpayer on July 1, 1929, was taxable income of the respondent and other stockholders notwithstanding Section 115(f) of the 1928 Act which declared that a stock dividend was not subject to tax. The Government then urged upon the court this further contention, by way of an alternative argument: if the stock in question was not taxable as a dividend at the time of its receipt, it was taxable at the time it was sold three months later, the income resulting from the sale being measured by the difference between a cost basis of zero and a sale price of $100 per share. This claim of the Commissioner had not been mentioned in his deficiency letter nor in his answer filed with the Board of Tax Appeals, nor had it been urged by the Commissioner at any time before the Board nor brought up by cross-appeal to the court below.

The court below reversed the decision of the Board, and in its opinion stated that the Board, by its second decision (June 27, 1935) "did not overrule the conclusions reached

June 29, 1933, wherein it was held that the preferred shares had not been redeemed in such manner as to make the transaction essentially equivalent to a taxable dividend", but that the Board in its second decision had held that the original distribution was not a tax-free stock dividend (*Gowran* v. *Commissioner,* 87 Fed. (2d) 125, 126, 127). The court assumed that the stock dividend in question, paid in preferred shares to holders of common, was income within the definition of the Sixteenth Amendment, but held that it was not taxable income in view of the express provision of Section 115(f) of the 1928 Revenue Act, viz: that a stock dividend shall not be subject to tax. As to the Commissioner's second and alternative contention, viz: that the taxpayer's cost basis on the dividend shares was zero and that he realized taxable profit when the shares were later sold, the court did not decline to pass on the point because of its not having been raised before the Board (which was the ruling of the Circuit Court of Appeals for the Second Circuit in *Pfeiffer* v. *Commissioner,* 88 Fed. (2d) 3), but considered the point on the merits and rejected it. The court held that fair market value of the dividend shares at date of receipt by the taxpayer, viz: $100 per share, was the basis for computing gain or loss on later sale, and that since they were sold for $100 per share there was no taxable income.

SUMMARY OF ARGUMENT.

Point I.

All stock dividends are exempt from taxation under the provisions of Section 115(f) of the Revenue Act of 1928. That section reads: "A stock dividend is not subject to tax." Whether the stock dividend received by respondent was income under the Sixteenth Amendment, or was not income at all, the statute quoted made it nontaxable at the time it was received, July 1, 1929. The language of the statute is plain, and does not admit of any search for a legislative intent differing from the words used. Section 115(f) is in harmony with the other provisions of the Revenue Act of 1928. Congress having inserted the section, without change, in six successive revenue acts, beginning with 1921 and ending with 1934, it is a necessary conclusion that it was the intent of Congress to confirm the administrative interpretation of the law which was made by the Treasury Department continuously through all of those years, viz: that all stock dividends of every kind were free of tax.

Point II.

The stock dividend in the instant case, having been paid in non-voting preferred stock to a holder of voting common stock, was not income within the meaning of the Sixteenth Amendment, because the distribution of the dividend did not result in the proportional interest of the stockholder becoming essentially different from what it had been before the distribution. In the absence of any such change of proportional interest, the dividend received by respon-

dent was no more income than it would have been if it had been a dividend in common stock on common.

Point III.

If the court below had power to consider and pass upon the basis of the dividend stock (a point not raised before or decided by the Board of Tax Appeals), then the decision of the court below was correct, viz: such basis was the fair market value of the dividend stock at the time acquired by respondent. This was stipulated to be $100 per share. Since he later sold the stock at $100 per share, there was no resulting gain in the transaction. The cost basis of the dividend stock was not zero, as urged by the Government, but was fair market value as in the case of tax-free gifts and legacies.

Point IV.

The question of the correct cost basis of the dividend stock, in the event of sale thereof by the recipient, was not mentioned in the Commissioner's deficiency letter to the taxpayer nor in the pleadings before the Board of Tax Appeals; was not brought up before the Board of Tax Appeals by argument, motion or in any other way; and was therefore not within the reviewing power of the Circuit Court of Appeals. When counsel for the Government urged that the Circuit Court of Appeals consider the question, and find a basis of zero for the dividend stock, that court ought to have declined to consider the point.

Point V.

The Government's contention that this case should now be remanded to the Board of Tax Appeals, for a new hearing and new determination with respect to the application of Section 115(g) of the Revenue Act of 1928, should be overruled. That section provides that if a corporation cancels or redeems its stock under circumstances which make the distribution and cancellation or redemption essentially equivalent to the distribution of a taxable dividend, the amount distributed in redemption or cancellation shall be treated as a taxable dividend. That was the issue originally presented in this case, and it was tried out before the Board of Tax Appeals and decided in favor of the taxpayer. The decision was in the form of the report of a division of the Board, and thirty days after the filing of this report it became the decision of the Board because review thereof was denied by the Board. The Commissioner has not at any time asserted error in the trial or determination of that issue. In deciding the issue on the evidence, the Board concluded that there had not been any redemption or cancellation of the dividend stock in a manner making the transaction equivalent to a taxable dividend, and that there had not been in fact any redemption or cancellation at all. No reason has been shown for a new trial of the factual issue.

ARGUMENT.

POINT I.

ALL STOCK DIVIDENDS ARE EXEMPT FROM TAXATION UNDER SECTION 115(F) OF THE REVENUE ACT OF 1928.

The language of the statute is so broad as to exempt from taxation all stock dividends, including those which do and those which do not constitute income to the shareholder. The language of the statute, Section 115(f) of the Revenue Act of 1928, is this: "A stock dividend is not subject to tax."

In its opinion in the *Koshland* case, this court said at page 445:

> "Although *Eisner* v. *Macomber* affected only the taxation of dividends declared in the same stock as that presently held by the taxpayer, the Treasury gave the decision a broader interpretation which Congress followed in the Act of 1921. Soon after the passage of that Act, this court pointed out the distinction between a stock dividend which worked no change in the corporate entity, the same interest in the same corporation being represented after the distribution by more shares of precisely the same character, and such a dividend where there had either been changes of corporate identity or a change in the nature of the shares issued as dividends whereby the proportional interest of the stockholder after the distribution was essentially diffeernt from his former interest. Nevertheless the successive statutes and Treasury Regulations respecting taxation of stock dividends remained unaltered."
>
> *Koshland* v. *Helvering*, 298 U. S. 441, 445.

Thus it is clear that a dividend declared in common stock to holders of common is a stock dividend, but is not income of the stockholders; also that a dividend declared

in stock of one class to holders of stock of another class is a stock dividend, and is income if the distribution of the dividend results in an essential change in the proportional interest of the stockholder in the corporation. If the stock dividend is not income, it cannot be taxed under the Sixteenth Amendment. If the stock dividend is income, it cannot be taxed because it is "not subject to tax" under the statute.

This is the interpretation of the *Koshland* case that has been adopted by the Board of Tax Appeals. In the case of *August Horrman* (October 31, 1936) the Board said:

> "But whether we are right or wrong in our interpretation of the Koshland case and whether or not the preferred stock dividend of 1932 was income, we are of the opinion that it was not taxable to the stockholders. Of course, if it was a stock dividend within the compass of *Eisner* v. *Macomber* it was not income under the Sixteenth Amendment; if it was income as in the Koshland case, it was nevertheless a stock dividend which was specifically exempt from tax under Section 201(d) of the Revenue Act of 1921."
>
> *August Horrman,* 34 B. T. A. 1178, citing *Eisner* v. *Macomber,* 252 U. S. 189.

The decision just cited came after the decisions of the Board in the case at bar and in the *Pfeiffer* case, and indicates that the Board finally conceded that its decisions were wrong in the two cases mentioned, and that *all* stock dividends must be deemed exempt from tax.

The Circuit Court of Appeals for the Second Circuit in the *Pfeiffer* case has indicated by its opinion that it also understands the Koshland decision to mean that all stock dividends are exempt from tax under the statute.

Pfeiffer v. *Commissioner,* 88 Fed. (2d) 3, 4.

There is nothing ambiguous about the term "stock dividend." When a corporation distributes fresh issues of its

own stock to its existing stockholders, it is a stock dividend.

14 C. J. 812.

7 Thompson on Corporations, 3rd Ed. (1927) p. 137.

2 Clark & Marshall, Private Corporations, Sec. 523 e, page 1601.

Gray v. *Hemenway,* 212 Mass. 239, 98 N. E. 789.

That the term "stock dividend" has this definite and well-understood meaning is shown by its repeated use in the successive Revenue Acts. Prior to the decision of this court in *Eisner* v. *Macomber,* 252 U. S. 189 (March 8, 1920), the law contained this definition:

> "* * * The term 'dividends' as used in this title shall be held to mean any distribution made or ordered to be made by a corporation * * * out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders, either in cash or in stock of the corporation, * * * which *stock dividend* shall be considered income to the amount of its cash value." (Emphasis supplied.)
>
> Section (2) (a) of Revenue Act of 1916.

The statute quoted was examined by this court in *Eisner* v. *Macomber,* and it was held that Congress did not have the power, under the Sixteenth Amendment or otherwise, to tax without apportionment a stock dividend such as that received by the taxpayer Macomber, and that therefore the Revenue Act of 1916, insofar as it imposed a tax upon the stockholders because of such a dividend, was invalid. In that case it appeared that the outstanding stock of the declarant corporation was all common stock, and that the stock dividend was distributed in shares of the same kind of stock, the total amount of the distribution being taken out of the earned surplus of the corporation. Under these circumstances the conclusion was that the corporation had

parted with nothing, and the stockholders had received nothing, the interest or equity of each stockholder being the same after the dividend as it was before. The court said:

> "A stock dividend shows that the company's accumulated profits have been capitalized, instead of distributed to the stockholders or retained as surplus available for distribution in money or in kind should opportunity offer."
>
> *Eisner* v. *Macomber*, 252 U. S. 189.

In the Revenue Act of 1921 the Congress, pursuant to its understanding of the meaning of the decision in the *Macomber* case, changed the law relative to stock dividends by providing that "a stock dividend shall not be subject to tax." This is the language of Section 201(d) of the 1921 Act, and it was re-enacted as Section 201(f) of the Revenue Acts of 1924 and 1926 and as Section 115(f) of the Revenue Acts of 1928, 1932 and 1934. There can be no possible doubt as to the meaning of the term "stock dividend" in view of the standard definitions and in view of its uniform and long-continued use by Congress. It should be noted that Congress again used the term in its standard sense in Section 115(f) of the Revenue Act of 1936, enacted after the decision of this court in the *Koshland* case (Act of June 22, 1936, c. 690, 49 Stat. 1648). By the 1936 Act a stock dividend which is income of the stockholder, within the meaning of the Sixteenth Amendment to the Constitution, is made subject to the income tax.

From *Gibbons* v. *Mahon* (1890) down to *Koshland* v. *Helvering* (1926) this court has used the phrase "stock dividend" in many decisions, and either expressly or by necessary implication has defined it as meaning what Congress and the Treasury Department have always assumed it meant, viz: the distribution by a corporation of fresh

issues of its own stock to its existing stockholders. A few of these decisions are:

Gibbons v. *Mahon,* 136 U. S. 549.
Towne v. *Eisner,* 245 U. S. 418, 424, 426.
Eisner v. *Macomber,* 252 U. S. 189, 199, 201.
Weiss v. *Stearn,* 265 U. S. 242, 253.
Koshland v. *Helvering,* 298 U. S. 441, 444, 445, 446.

It is a stock dividend whether the stock distributed is common stock to present holders of common or is preferred stock to present holders of common or is common stock to present holders of preferred. The term "stock dividend" is not limited by law to a distribution of stock of the same class or preference as that on which the dividend is paid. This was understood by the Treasury Department when it changed its regulations in 1920 so as to provide a method for allocating the cost of the original shares between such shares and the dividend shares for the purpose of determining gain or loss on sale of either, for these changes in the regulations included specific provisions for the handling of the problem "where the stock issued as a dividend is in whole or in part of a character or preference materially different from the stock upon which the stock dividend is paid." (Treasury Decision 3059, 3 C. B. 38). Thereafter for more than fifteen years the Treasury Department, by its regulations and decisions, continued to assert that a stock dividend included not only dividend shares of the same class as those previously held by the stockholder but dividend shares of a different class as well. That such is the view of this court is clear from the language used in the *Koshland* case on page 444:

> "After the decision the Treasury revoked regulations to the effect that a dividend paid in the corporation's stock is income and issued amended regulations, broadly phrased, that exempt all income *in the form of stock dividends, whether the dividend shares be of the same class as those theretofore held by the stockholder or of a different class.*" (Emphasis supplied.)

Thus we have a statute that says in plain and unambiguous language that "a stock dividend shall not be subject to tax." There are no words of qualification or limitation, so that "a stock dividend" must mean *any* stock dividend whether of common shares on common or of preferred shares on common, and whether constituting income under the Constitution or not constituting such income. There is no room here for construction or interpretation, and no occasion for an examination of the Congressional Committee Reports to ascertain what Congress meant by this enactment.

> "We are not at liberty to construe language so plain as to need no construction or to refer to Committee Reports where there can be no doubt of the meaning of the words used."
>
> *Helvering* v. *City Bank Farmers Trust Co.*, 296 U. S. 85.

> "It is elementary that where no ambiguity exists there is no room for construction".
>
> *United States* v. *Missouri Pacific R. R. Co.*, 278 U. S. 269, 277.

> "The words being clear, they are decisive. There is nothing to construe. To search elsewhere for a meaning either beyond or short of that which they disclose is to invite the danger, in the one case, of converting what was meant to be open and precise into a concealed trap for the unsuspecting, or, in the other, of relieving from the grasp of the statute some whom the legislature definitely meant to include."
>
> *Van Camp & Sons Co.* v. *American Can Co.*, 278 U. S. 245, 253.

Section 402 of the Revenue Act of 1918 was the statute passed upon by this court in *Crooks* v. *Harrelson* (1930). The statute subjected to an estate tax the real estate of a decedent only if such real estate was subject to (a) charges

against the estate, (b) expenses of administration, and (c) distribution as part of the estate. Under the law of Missouri, real estate of a decedent was not subject to expenses of administration. This court held that it was therefore necessary to exclude from the estate of the decedent all of his real estate. In answer to one of the arguments of counsel for the Government, this court said:

> "It is urged, however, that if the literal meaning of the statute be as indicated above, that meaning should be rejected as leading to absurd results, and a construction adopted in harmony with what is thought to be the spirit and purpose of the Act in order to give effect to the intent of Congress. The principle sought to be applied is that followed by this court in *Church of the Holy Trinity* v. *United States*, 143 U. S. 457; but a consideration of what is there said will disclose that the principle is to be applied to override the literal terms of a statute only under *rare and exceptional circumstances* (Emphasis supplied). The illustrative cases cited in the opinion demonstrate that to justify a departure from the letter of the law upon that ground, the absurdity must be so gross as to shock the general moral or common sense. Compare *Pirie* v. *Chicago Title & T. Co.*, 182 U. S. 438. And there must be something to make plain the intent of Congress that the letter of the statute is not to prevail. *Treat* v. *White*, 181 U. S. 264.
>
> "• • • In support of the claim that a literal construction is not admissible it is said that by other provisions of Section 402 certain interests in real property, such as dower, etc., are made subject to the tax without regard to the conditions set forth in subdivision (a), and that this results in an incongruity amounting to an absurdity. But unless the constitution be violated, Congress may select the subjects of taxation and qualify them differently as it sees fit; and if it does so in plain terms, as it has done here, it is not within the province of the court to modify the law by construction. • • •
>
> "Finally, the fact must not be overlooked that we are here concerned with a taxing act, with regard to which the general rule requiring adherence to the letter applies with peculiar strictness. In *United States*

v. *Merriam*, 263 U. S. 179, after saying that 'in statutes levying taxes a literal meaning of the words employed is most important, for such statutes are not to be extended by implication beyond the clear import of the language used', we quoted with approval the words of Lord Cairns in *Partington* v. *Atty. Gen.*, L. R. 4 H. L. 100, 122, that 'if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be.'"

Crooks v. *Harrelson*, 282 U. S. 55, 59, 61.

In *Old Colony R. R. Co.* v. *Commissioner*, this court still further emphasized the necessity of ascribing to statutes, especially taxing statutes, the ordinary and plain meaning of the words used by the Legislature. This was a tax case also, and the Government contended that the word "interest", used in the sense of a return on loaned capital, must be given a special and restricted meaning in order to carry out the intent of the income tax law. The contention was rejected, this court holding that the legislature must be presumed to use words in their known and ordinary signification; that the plain meaning of a statute is always to be preferred to any narrow or hidden sense; and that this rule is applied to tax acts (citing *De Ganay* v. *Lederer*, 250 U. S. 376). The opinion goes farther, and says that if there were any doubt as to the meaning of the term, the fact of its use in a tax statute would incline the scale to the construction most favorable to the taxpayer (citing *Gould* v. *Gould*, 245 U. S. 151; *United States* v. *Merriam*, 263 U. S. 179; *Bowers* v. *N. Y. & A. Lighterage Co.*, 273 U. S. 346; *United States* v. *Updike*, 281 U. S. 489; *Burnet* v. *Niagara Falls Brewing Co.*, 282 U. S. 648).

Old Colony R. R. Co. v. *Commissioner*, 284 U. S. 552, 560, 561.

As pointed out by this court in the *Koshland* case, Congress supposed in 1921 that the *Macomber* decision meant

that no stock dividend could constitute income under the Sixteenth Amendment, and proceeded to amend the statute in accordance with this view. All stock dividends were made non-taxable, and were kept so by the Revenue Acts of 1924, 1926 and 1928. Whether or not Congress would have taxed that type of stock dividend which constitutes income, if Congress had known that such a type of stock dividend existed, is a matter of pure speculation. It has nothing to do with the rights or liabilities of this taxpayer in respect of the stock dividend which he received in 1929. The Government can hardly argue that Congress, unconsciously and without knowledge that it had constitutional power to do it, placed an income tax on certain kinds of stock dividend by the Act of 1921, or by the successive Acts of 1924, 1926 and 1928. The fact of the matter is quite evident: Congress learned after the announcement of the decision of this court in the *Koshland* case that there were certain types of stock dividend which constitutionally might have been subjected to tax, but which had not been subjected to tax, and then proceeded to remedy the situation by changing this portion of the law to the form now found in Section 115(f) of the Revenue Act of 1936. By that section Congress imposed a tax where none had previously existed.

The Government's argument suggests that Section 115(f) of the Revenue Act of 1928 cannot mean what it says for the reason that exempting stock dividends from tax is inconsistent with the rest of the statute. It is believed unnecessary to challenge this position by extended argument. Complete consistency in the law was accomplished by the Revenue Act of 1921, by granting an exemption to stock dividends and by modifying the general definition of the term "dividend" so as to eliminate from its scope any distribution made in "stock of the corporation". This brought all of the provisions of the statute into harmony, and there

was no further change in this respect until the enactment of the Revenue Act of 1936.

Counsel for the Government urge in their brief that when Congress wrote into the income tax law, in 1921, the language that continued there and became Section 115(f) of the Revenue Act of 1928, the intent of Congress must have been to exempt from tax only such stock dividends as were not "income" within the meaning of the Sixteenth Amendment; and that if such was the intent of Congress, the section should not be read literally. The best answer to this contention is that the repeated re-enactment by Congress of the provision exempting stock dividends, without changing its language in any way, clearly indicated that Congress had approved and continued to approve the executive construction of the statute.

Shortly after the decision of this court in the *Macomber* case, the Treasury Department issued Treasury Decision 3052, 3 C. B. 38 (August 4, 1920), whereby it assured Internal Revenue officers and taxpayers that all stock dividends were tax-free in consequence of the *Macomber* decision. A few days later the Treasury Department revised its regulations then in effect (Regulations 45, issued under the Revenue Act of 1918) by revoking Article 1545 and amending Article 1547, the result being a provision that "stock received as a dividend does not constitute taxable income to the stockholders". The change in the regulations thus accomplished included specific directions for ascertaining cost of original shares and of dividend shares, for the purpose of computing gain or loss on sale of either. Treasury Decision 3059, 3 C. B. 38.

Soon after issuing the Treasury Decision last referred to, the Treasury Department put out Office Decision 732 (3 C. B. 39), whereby more detailed directions were given as to the adjustment of cost of both classes of stock where preferred is issued as a dividend on common.

The Treasury Department still later issued O. D. 801, 4 C. B. 24, which stated: "A stock dividend paid in true preferred stock is exempt from tax the same as though the dividend were paid in common stock".

Thus it is clear that the Treasury understood the *Macomber* decision to mean that *all* stock dividends must be exempted from income tax under the Constitution, and Congress accepted the Treasury's interpretation of the decision when it wrote into the 1921 Revenue Act, as Section 201(d), the words which later constituted Section 115(f) of the Revenue Act of 1928, viz.: "A stock dividend shall not be subject to tax". That it was the intent of Congress to follow the interpretation of the Treasury Department is confirmed by the language of this court in the *Koshland* case:

> "Although *Eisner* v. *Macomber* affected only the taxation of dividends declared in the same stock as that presently held by the taxpayer, the Treasury gave the decision a broader interpretation which Congress followed in the Act of 1921." (p. 445 of opinion).

In this matter of the exemption of all stock dividends from tax, the Treasury Regulations and Decisions continued without material change until 1936; and during that period Congress repeatedly re-enacted the clause exempting stock dividends from tax, necessarily with full knowledge of the administrative interpretation of it. The same clause appeared in six successive Acts of Congress, without change.

Nearly thirty years ago this court stated unequivocally that "we have decided that the re-enactment by Congress, without change, of a statute which had previously received long-continued executive construction, is an adoption by Congress of such construction".

United States v. *Cerecedo Hermanos y Compania*, 209 U. S. 337, 339.

This court has reiterated the rule in many later decisions, of which the following are cited:

National Lead Co. v. *United States,* 252 U. S. 140, 146, 147.

Brewster v. *Gage,* 280 U. S. 327, 337.

McCaughn v. *Hershey Chocolate Co.,* 283 U. S. 488, 492, 493.

Murphy Oil Co. v. *Burnet,* 287 U. S. 299, 302, 303.

Massachusetts Mutual L. Ins. Co. v. *United States,* 288 U. S. 269, 273.

United States v. *Dakota-Montana Oil Co.,* 288 U. S. 459, 466.

Old Mission Portland Cement Co. v. *Helvering,* 293 U. S. 289, 293, 294.

The language of the statute here under discussion is too plain to justify any search for a legislative intent differing from the words used. But if legislative intent must be ascertained, it is submitted that such intent was made manifest by including the same words in six successive revenue acts through a period of thirteen years, during which time the Government's administrative interpretation of the law remained unchanged. This conclusion is hardly affected by the remark of Representative Vinson of Kentucky, during the debate preceding the adoption of the 1936 Revenue Act, to the effect that the proposed plan of taxing stock dividends does not change the law. (Quoted by counsel for the Government on page 20 of their brief.) Even if Mr. Vinson represented the "intent of Congress" in 1936, he did not indicate the intent of Congress at the time of the enactment of the 1928 Revenue Act.

What Representative Vinson said, according to the matter quoted on page 20 of the Commissioner's brief, was that under the 1934 Act there was a provision that said *no stock dividend should be taxed,* and then he proceeded to explain

that, without departing from the law as handed down by the Supreme Court in the case of *Eisner* v. *Macomber* it was proposed to tax certain stock dividends. This interpretation of his meaning is supported by his statement of April 27, 1936, reported in the Congressional Record of that day, at page 6214:

> "Existing law provides that no tax shall be levied upon stock dividends. We strike that from this bill. There are innumerable types of stock dividends that are taxable under the Constitution and under the celebrated case of *Eisner* v. *Macomber.*"

Further, on April 28, 1936, there was a colloquy between Representative Vinson and Representative Treadway, found at page 6309 of the Congressional Record of that day. Mr. Treadway quoted the clause which had been a part of all of the Revenue Acts since 1921, viz.: "A stock dividend shall not be subject to tax", and said:

> "That is the existing law and has been the law most of the time since the *Eisner* v. *Macomber* decision. In the next tax bill after that decision that language was included. I understand the gentleman's explanation to be that the language of the Act was too broad. I do not mean too broad in the sense it is not legal, but it goes further than the *Eisner* v. *Macomber* decision.
>
> "Mr. Vinson of Kentucky: That is correct."

It is respectfully urged that the stock dividend was not subject to tax when received by respondent, in any aspect of the case; that if the stock dividend was income, the statute made it non-taxable, and if it was not income it could not be taxed under the Sixteenth Amendment; and that the meaning of the statute, Section 115(f) of the Revenue Act of 1928, is clear, unambiguous, in harmony with the rest of the Revenue Act and obviously expresses the actual intent of Congress.

Point II.

THE STOCK DIVIDEND IN THIS CASE, PAID BY THE COMPANY IN ITS OWN PREFERRED STOCK TO HOLDERS OF COMMON, DID NOT CONSTITUTE INCOME OF THE RESPONDENT UNDER THE SIXTEENTH AMENDMENT.

It may not be necessary for this court to pass on this Point II. If it is decided that the stock dividend when received by respondent was not subject to tax under the Revenue Act of 1928, and that the question of the cost basis of the dividend shares sold by the taxpayer was correctly decided by the court below (or was not properly before that court for decision), the judgment of the court below will be affirmed regardless of the question of income under the Sixteenth Amendment.

However, counsel for the Government argue that respondent taxpayer received income at the time the dividend stock was delivered to him, even though the dividend in question was in the form of preferred shares delivered to a holder of common, which was the converse of the situation disclosed in the *Tillotson* and *Koshland* cases. In both of those cases, the dividend was paid in common shares to persons holding preferred:

Tillotson Mfg. Co. v. *Commissioner,* 76 Fed. (2d) 189.

Koshland v. *Helvering,* 298 U. S. 441.

Respondent submits the following in support of his contention that in the instant case the stock dividend did not constitute income under the Amendment.

This court has definitely held, by its decisions in the *Macomber* and *Koshland* cases, that a dividend paid in common shares on common does not constitute income under the Sixteenth Amendment, and that a dividend paid

in common shares on preferred does constitute income under the Sixteenth Amendment. The reason why a dividend of common on preferred results in income is that it produces a change in the proportional interests of the recipient stockholder.

If a dividend paid in preferred shares to holders of common, under the circumstances disclosed by the record here, did not result in the proportional interest of the stockholder becoming *essentially* different from what it had been before the distribution, then the stockholder received no income. In the absence of a change in proportional interest, a stock dividend paid in preferred on common is precisely the same thing as a stock dividend paid in common on common.

It has been shown that the preferred stock of the company carried a preferential dividend limited to seven per cent. per annum, payable out of profits only; that there was no provision in the company's articles of incorporation requiring any of the earned surplus to be reserved for payment of dividends on preferred stock; that preferred stock had no voting power under any circumstances; that on liquidation of the company, preferred stock would be paid off preferentially up to but not exceeding its par value of $100 per share; that the common stock carried all of the voting power, was entitled to receive unlimited dividends out of profits after payment of dividends on preferred, and was entitled to receive all of the net assets of the company on liquidation after payment of par to the preferred. Fair market value of the dividend stock when received by respondent was $100 per share.

Did the distribution of preferred stock to the respondent taxpayer, by way of dividend, result in his proportional interest becoming *essentially* different from what it had been before? Upon the facts established in the instant case, the answer would appear to be in the negative.

The dividend did not change voting power in the corporation. Since no part of the earned surplus was reserved for the benefit of preferred stockholders, the entire earned surplus was part of the stock equity of the common stockholders; and when the taxpayer received from the company a stock dividend valued at $53,300, his equitable interest in the earned surplus diminished by precisely that amount. The distribution of this stock dividend did not exhaust the earned surplus. A liquidation of the corporation immediately following the distribution of this stock dividend would have paid out to the taxpayer precisely the same amount that he would have received if there had been no such dividend. In other words, after the receipt of this dividend in preferred stock, the taxpayer's equity in the corporation,—his "proportional interest"—was not essentially different from what it had been before.

It must also be remembered that the dividend did not take from Hamilton Manufacturing Company any of its assets, nor did it increase any of its liabilities. It is submitted that since (a) the company parted with nothing, and (b) the stockholder received no net increase in his interest in the company, there was actually no income to the stockholder.

In the *Koshland* case, the stockholder, holding non-voting preferred stock, received in the dividend certain shares of voting common stock. This worked a distinct change in the stockholder's proportional interest in the company. She not only acquired voting power, which previously she had not had, but she acquired a block of stock carved out of the company's earned surplus, in which earned surplus she had not previously had any right or interest.

In the instant case, the stockholder receiving the stock dividend was no richer after he had received it than he was before. In the *Koshland* case the stockholder was richer

after the dividend, the amount of her enrichment being measured by the fair market value of the common shares received.

The Board of Tax Appeals decided the *Frances Elliott Clark* case after it had decided the *Tillotson* case. Here the dividend was declared on common stock but paid in preferred. It was urged before the Board that the *Tillotson* case was authority for holding that this distribution of preferred stock was taxable income of the stockholder. The Board held to the contrary, pointing out that in the *Tillotson* case there was a distribution of common stock in payment of a dividend on preferred, and that such a distribution was not a proportional redistribution of existing rights. In the *Clark* case it was the Commissioner who argued that the *Tillotson* case should not control, and the Board sustained the Commissioner's position and held that when the corporation distributed a dividend in its preferred stock, declared and paid on its outstanding common, "petitioner received thereby a stock dividend, which neither constitutionally (*Eisner* v. *Macomber*, 252 U. S. 189), nor by statute (Section 201(f) of the Revenue Act of 1926), is subject to income tax". This decision of the Board was affirmed by the Circuit Court of Appeals for the Third Circuit, without discussion of the constitutional question of income.

Clark v. *Commissioner*, 28 B. T. A. 1225, 77 Fed. (2d) 89.

In making its second decision in the instant case, whereby the Board held respondent liable for a deficiency, the Board did not follow its conclusions as set forth in the *Clark* case, which involved a dividend paid in preferred stock on common, but went back to the *Tillotson* case, which related to a dividend in common on preferred; and the Board decided that the preferred stock dividend received by respondent

changed his interest in the corporation in substantially the same manner as in the case of the stockholder receiving a stock dividend in common stock paid on preferred. The Board therefore held that respondent had received income, and also that it was taxable. The court below in this case, and the Circuit Court of Appeals for the Second Circuit in the *Pfeiffer* case, both assumed without discussion that a stock dividend in preferred stock on common stock is income, as is a dividend in common stock on preferred stock. In both cases, however, it was unnecessary for the courts to rule on this question, since they both held that the dividend was tax-free under the statute in any case.

No other decided cases, so far as we have been able to discover, have touched on the question. We have set forth above the reason why respondent feels that in this instance, at least, his proportional interest in the corporation was not essentially different after he received the stock dividend from what it had been before. If he is right in that, then he did not receive income, and his case is ruled by the decision of this court in *Eisner* v. *Macomber*. The result would be a judgment of no deficiency.

Before leaving this point it should be noted that counsel for the Government in their brief appear to lay emphasis on the fact that at the time the stock dividend in question was received by respondent, in the form of preferred shares, other preferred shares of the company were already outstanding in the hands of persons other than respondent. It is difficult to understand why this situation has anything to do with the question of income of the respondent. Under the circumstances of this case, the stock equity or "proportional interest" of the *stockholder receiving the dividend* remained the same, as has been shown, even though other persons held preferred stock before the dividend.

It may be argued that if the company later suffered important losses, sufficient to wipe out its earned surplus and the equity of its common stockholders and a part of the equity of its preferred stockholders, a liquidation of the company would pay something more to the stockholder who retained the preferred shares received in the dividend than he would be able to realize if he had not received them; but it is submitted that the test of income at the time the dividend shares are received must be a change of interest occurring *at that time,* and not an alteration of stock equities that may or may not occur at some time in the remote future.

There appears further to be an insuperable difficulty in *measuring* respondent's income, if his dividend of preferred stock on common is to be considered income. It has been seen that where the stock classifications are substantially the same as in this case, the holder of preferred stock who receives common stock in a dividend is enriched because his new stock comes out of a surplus in which he previously had no share or interest; and the measure of his enrichment is the fair market value of the common stock received. But the holder of common stock who receives preferred stock in a dividend is not enriched at all. The value of the new stock received is exactly balanced by the shrinkage of his share of the corporate surplus; and, further, the fair market value of the preferred stock which he receives in the dividend cannot possibly measure his income, even if income is present because of a change in his proportional interest in the corporation. This change in proportional interest, if an advantage to the stockholder at all, would not be an advantage measured by the fair market value of the shares received. Compare *Towne* v. *Eisner,* 245 U. S. 418, 426.

Point III.

THE COST-BASIS, SO CALLED, OF THE STOCK DIVIDEND IN THIS CASE WAS THE FAIR MARKET VALUE OF THE STOCK WHEN RECEIVED BY THE TAXPAYER.

In his briefs and argument before the Circuit Court of Appeals, the Commissioner set up as an alternative ground of tax liability a new theory which had not until then been considered or even mentioned at any time in these proceedings. This new theory will be referred to here as the "basis-of-zero" theory.

As has been shown in this brief (see "Statement of the Case", page 3, *et seq*), the Commissioner first asserted a deficiency against the respondent taxpayer on the ground that the latter had sold his dividend stock back to the company under such circumstances as to result in taxable income under Section 115(g) of the Revenue Act of 1928. The decision of the Board was against the Commissioner on this point, and there has been no appeal from it. The Commissioner next advanced the contention that when the taxpayer received the dividend stock of July 1, 1929, he then and there received taxable income because the dividend stock was of a different class from that which the taxpayer had previously held. On this theory, the Board of Tax Appeals sustained the Commissioner, but was reversed by the Circuit Court of Appeals. The third, or "basis-of-zero" theory, was first advanced by the Commissioner when the case was argued in the Circuit Court of Appeals. The taxpayer urged in that court that this new basis-of-zero theory could not properly be passed upon by the court, because it was a contention not made by the Commissioner's deficiency letter nor referred to in the

pleadings filed with the Board of Tax Appeals nor brought up in any way by argument or brief before the Board, nor brought into the Circuit Court of Appeals by cross-appeal or otherwise. The Circuit Court of Appeals nevertheless did consider and pass upon the basis-of-zero theory, but decided against the Commissioner on the merits, holding that the cost basis of the dividend shares when sold was their fair market value at the time they were received by the taxpayer, or $100 per share, and that when later sold at $100 per share there was no gain.

The taxpayer contends in this court that the Circuit Court of Appeals was correct in its decision on the merits, if that court was entitled to pass upon the basis-of-zero theory at all, and discussion of the merits follows. Under Point IV of this brief respondent will argue the question of whether the basis-of-zero theory was ever properly before the court below for decision.

It will no doubt be conceded that if the dividend shares when received by the taxpayer were not free of tax, they would have been valued at their fair market price for the purpose of computing the tax thereon. Apparently the Commissioner contends that the so-called cost basis of the dividend shares would have been fair market value if they were subject to tax, but must be considered zero if not subject to tax. It is difficult to justify such an argument.

Section 113 of the Revenue Act of 1928 provided that the basis of determining gain or loss from the sale or other disposition of property is the "cost" of the property. Where property is acquired by purchase the term "cost" is synonymous with the term "purchase price"; but this court has expressly held that where property does not have a "cost" in the conventional sense and the Revenue Act does not prescribe otherwise, the basis of the property is the fair market value at date of acquisition by the taxpayer.

In *Hartley* v. *Commissioner*, 295 U. S. 216, the court said at pp. 218-219:

> "The Court of Claims held that the time of acquisition, indicated by Sec. 202(a) of the 1921 Act and Sec. 204(a) of the 1924 and 1926 Act as the controlling date for calculating gain or loss to the estate in the course of administration, must be taken to be the date of acquisition by the decedent rather than the time of acquisition by the executor or administrator on the decedent's death. This conclusion, it was thought, was compelled by the statutory command that the basis of computation shall be 'cost', which could have no application to the acquisition by the executor or administrator, who is not a purchaser of the estate which he administers. *McKinney* v. *United States, supra* (62 Ct. Cl. 188). But this specification is not enough to restrict the effect of the general provisions of these revenue acts which impose a tax on the income, including capital gains, of taxpayers. *The use of the word cost does not preclude the computation and assessment of the taxable gains on the basis of the value of property, rather than its cost, where there is no purchase by the taxpayer, and thus no cost at the controlling date.* See *Heiner* v. *Tindle*, 276 U. S. 582, 585, 586, 72 L. ed. 714, 716, 717, 48 S. Ct. 326; *Lucas* v. *Alexander*, 279 U. S. 573, 578, 579, 73 L. ed. 851, 854, 855, 49 S. Ct. 426, 61 A. L. R. 906." (Emphasis supplied.)

The rule is, as indicated in the above quotation, that the basis of property acquired otherwise than by purchase is its fair market value when acquired, unless there is an express statutory provision prescribing some basis other than "cost". The principle has been consistently recognized by the Commissioner, the Board of Tax Appeals and the courts, in a variety of situations and irrespective of whether the acquisition of the property resulted in taxable income.

Note the Commissioner's application of the principle in the regulations (relating to the Revenue Act of 1918) which

pertain to property acquired by gift, bequest, devise or descent. The 1918 Act established the basis of property, when sold or otherwise disposed of, as its "cost", and contained no other provision that could be applied to property acquired otherwise than by purchase, such as gifts or bequests. The article of the regulations just referred to say that in the case of property acquired by gift, bequest, devise or descent, the basis for computing gain or loss on a sale of the property is its fair market value at date of acquisition. (Article 1562, Regulations 45.)

Under the Revenue Act of 1921, "cost" was the basis prescribed for computing gain or loss on later sale. In a case where a trustee had acquired property by a transfer in trust, not having paid anything for it, the Board of Tax Appeals said:

> "* * * The Act fails to specifically prescribe a cost basis to the trustee for the stock acquired by it as aforesaid. That being so, the cost basis to the trustee is the value of the property at the time acquired. (*Francis Francis* v. *Commissioner,* 15 B. T. A. 1332; *Rice* v. *Eisner,* 16 Fed. (2d) 358)".
>
> *Bankers Trust Co. v. Commissioner,* 24 B. T. A. 10.

To the same effect see:

Francis Francis v. *Commissioner,* 15 B. T. A. 1332.
Ward v. *Commissioner,* 29 B. T. A. 1251.

The principle that the fair market value of the property at date of acquisition must be used as its cost basis, when acquired otherwise than by purchase, is supported by the decision of the Circuit Court of Appeals for the Fifth Circuit in a case where land was acquired by gift. The Revenue Act of 1921 was the applicable statute. It prescribed no basis other than "cost" for the allowance of depletion on property so acquired. The court said:

> "We think the Board (of Tax Appeals) was correct in adopting the fair market value as the price or cost

of property acquired in that manner. Cost does not always mean the price paid for a thing."

Lucas v. *Daniel,* 45 Fed. (2d) 58, 60.

The same rule was applied by the Circuit Court of Appeals for the Seventh Circuit in the instant case. In overruling the Commissioner's contention that the basis of the dividend stock was zero, the court said:

"We liken the receipt of the tax-free income in the present case to that of a tax-free gift, bequest, legacy or other tax-free addition to the taxpayer's estate. One who receives a tax-free gift and later sells it, in the absence of statute providing otherwise, is taxed upon the profit arising from the difference in its value at the time he receives it and the sale price. Similarly one who receives a tax-free bequest, when selling it, is taxed upon the profit arising from any excess of the sale price over its fair market value at the time of receipt. The measure of liability of the taxpayer here is to be determined by the same standard; his tax, in case of sale, is to be computed just as if the dividend had not been tax-free. He must account for any difference between the stipulated value of $100.00 and the selling price. If this property were added to his estate by inheritance, and if there were no laws taxing it, upon sale of the same, under the established policy of the revenue laws of the United States, a tax would be assessed upon any profit resulting from a sale in excess of its value at the time he received it. The same yardstick must apply here."

Gowran v. *Commissioner,* 87 Fed. (2d) 125, 128.

This court's view of fair market value as a basis is well illustrated by the language of the decision in *Heiner* v. *Tindle,* a case which arose under the Revenue Act of 1918. The opinion there refers also to property acquired by gift, bequest or devise, and goes on to say:

"But it is pointed out that sec. 202 of the Revenue Act of 1918, prescribing the method of computing gain or loss upon the sale of property, makes value as of

March 1, 1913, or cost if acquired later, the basis of the computation * * *

"But it is obvious that sec. 202 is not all inclusive. The same and no greater inconsistency and difficulty arise in the case of property acquired by gift, bequest or devise, when *market value at the time of acquisition by the donee and not cost* is necessarily the basis of computing the tax. That in such cases the difference between the sale price and market value at the date of acquisition, if after March 1, 1913, is deductible under subsection (a) (5), is not questioned." (Emphasis supplied.)

Heiner v. *Tindle*, 276 U. S. 582, 585, 586.

The recent decision of this court in the *Koshland* case is not in conflict with the foregoing. In the *Koshland* case the taxpayer acquired certain shares of preferred stock by *purchase*, and later sold them. It was held that the purchase price was the cost, and that the cost was the basis for determining gain or loss on subsequent sale, as prescribed by Section 113 of the 1928 Revenue Act. In the *Koshland* case, none of the dividend stock had been sold, and accordingly the court did not pass on the basis of the dividend stock at all.

On page 27 of the Government's brief there is an argument to the effect that the analogy between tax-free gifts and devises on the one hand and stock dividends on the other does not exist, since "the reason for adopting the value at the time of acquisition as the basis for gifts and legacies is not present here". It is said that the value of a gift is subject to a gift tax and the value of a legacy is subject to an estate tax. But the analogy is perfectly good when made in respect of a stock dividend received by the taxpaper on July 1, 1929, for at that time there was no gift tax at all, and an estate of $100,000 or less could have been received by the taxpayer as a legacy or bequest free of estate tax.

If the stock dividend was not income, the *Koshland* decision does not apply; the dividend stock was an accretion of capital; the applicable regulations (Regulations 74, Articles 58 and 600) were valid; and petitioner correctly apportioned the cost of the dividend shares and correctly computed his taxable profit when he sold them.

If the stock dividend was income, but not taxable under Section 115 of the Revenue Act of 1928, the Government's basis-of-zero argument brings us to a curious and wholly illogical result, viz: *two* incomes growing out of the acquisition and sale of the dividend stock. Receipt of a hundred-dollar share of dividend stock would mean dividend income of $100 per share, tax free by statute, and the later sale of the same share would mean a capital-gain income of $100 per share, subject to tax. The difficulty disappears at once if we adopt the view of the court below.

Since in the case at bar the fair market value of the dividend stock was $100 per share when acquired, and since the taxpayer later sold the stock for $100 per share, there was no resulting gain to the taxpayer. The conclusion of the Circuit Court of Appeals on this point was correct.

Point IV.

THE QUESTION OF THE CORRECT COST BASIS OF THE DIVIDEND STOCK WAS NOT PROPERLY RAISED IN THE COURT BELOW.

The Commissioner's three separate theories of tax liability, asserted at different times since the inception of this proceeding in 1931, have been described at the beginning of the discussion under Point III of this brief. The first and original theory, if upheld, would have meant the receipt of *dividend* income by respondent in the sum of $100 per share on October 1, 1929, when he sold the dividend stock at

that price; the second, if upheld, would have meant the receipt of *dividend* income by the respondent in the sum of $100 per share on July 1, 1929, when he received the dividend stock; while the third, if upheld, would have meant a *capital gain* to the respondent, taxable at a different rate and under different regulations from those applicable to dividend income.

We believe the law is well settled that neither party to a tax proceeding of this kind is entitled to have the Circuit Court of Appeals or the Supreme Court pass upon a contention which was never made before the Board of Tax Appeals, was never mentioned in any pleading, argument or brief before that Board, nor in the Commissioner's notice of deficiency to the taxpayer, nor in any cross-appeal from the Board; and it would seem that the rules of law now so well settled in this conection must be fortified, in the instant case, by the fact that the Commissioner's third and final theory of tax liability would change the income which it is proposed to assess from dividend income to income by way of capital net gain.

In *General Utilities & Operating Company* v. *Helvering*, 296 U. S. 200, 206, this Court ruled in an identical situation:

> "The second ground of objection, although sustained by the Court, was not presented to or ruled upon by the Board. The petition for review relied wholly upon the first point; and, in the circumstances, we think the Court should have considered no other. Always a taxpayer is entitled to know with fair certainty the basis of the claim against him. Stipulations concerning facts and any other evidence properly are accommodated to issues adequately raised."

Helvering v. *Salvage*, 297 U. S. 106, 109, is to the same effect. There this Court held:

> "The defense of estoppel was not before the Board. Under what we regard as the correct practice, *General Utilities & Operating Co.* v. *Helvering*, 296 U. S. 200, the court should have passed the point."

The rule announced in the two foregoing cases has been followed in *Pfeiffer* v. *Commissioner*, 88 Fed. (2d) 3; *Sunset Scavenger Co.* v. *Commissioner*, 84 Fed. (2d) 453; and *Helvering* v. *Montana Life Insurance Company*, 84 Fed. (2d) 623. In the *Pfeiffer* case, the Circuit Court of Appeals for the Second Circuit said:

> "The question of taxability as capital gain of the $200,000, or any part thereof, was not in issue before or decided by the Board of Tax Appeals. The contention that we have authority to sustain the deficiency *pro tanto* even though the issue was not raised before the Board nor decided by it, nor assigned as error in the petition to this Court for a review of the Board's decision is untenable. (Citing *General Utilities & Operating Co.* v. *Helvering, supra,* and *Helvering* v. *Salvage, supra*)".

In the *Sunset Scavenger Co.* case, the Circuit Court of Appeals for the Ninth Circuit said, referring to a point raised for the first time before the Circuit Court of Appeals:

> "However novel this argument may be, the opinion of the Board does not disclose that the argument was ever presented to it. * * * Under such circumstances, we cannot consider the point. (Citing *General Utilities & Operating Co.* v. *Helvering, supra,* and *Helvering* v. *Salvage, supra*)".

In the *Montana Life Insurance Company* case, the Circuit Court of Appeals for the Ninth Circuit said:

> "The powers of this court are appellate in nature to review errors committed by the Board of Tax Appeals. It being conceded in this case that the Board of Tax Appeals has committed error, we are required to reverse that decision. We find no occasion to enter into a discussion of questions which were not decided by the Board of Tax Appeals, and we have no power to decide such questions * * * (Citing *General Utilities & Operating Co.* v. *Helvering, supra.*)"

All of the cases last cited were tax cases. All of them passed upon and decided the question of whether a claim

of tax liability "not in issue before or decided by the Board of Tax Appeals," might properly be considered and decided by the Circuit Court of Appeals. All of them ruled the question in the negative. Respondent urges that the Government should not have been permitted by the court below to argue its basis-of-zero theory at all, because it raised an issue not pleaded, tried, argued or otherwise referred to in the proceedings before the Board.

In their argument *contra,* counsel for the Government cite *United States* v. *American Railway Express Co.,* 265 U. S. 425, *Langnes* v. *Green,* 282 U. S. 531, and *Stelos Co.* v. *Hosiery Corp.,* 295 U. S. 237. None of these cases is a tax case. None has anything to do with the nature or scope of the review by a Circuit Court of Appeals in cases brought there, by the statutory process, from the Board of Tax Appeals. The *American Railway Express Co.* case reached this court by direct appeal from the District Court for the Northern District of Georgia, three judges sitting; and the claim, consideration of which by this court was opposed by the Express Company, had been "adequately presented in the bill of complaint." That situation was nothing like that of respondent taxpayer in the court below, when in that court he pointed out that the new issue had not been pleaded nor even mentioned in the proceedings before the Board. *Langnes* v. *Green* was an admiralty case, involving proceedings to limit liability of a vessel owner. This court held that a contention made by respondent in the court below, and there overruled, might be urged in this court in support of the judgment in respondent's favor below, without his having filed a cross appeal. All of the matters there involved had been pleaded in and decided by the trial court (the district court). *Stelos Co.* v. *Hosiery Corp.* was a patent case. This court held that the defendants might have urged the point as to in-

validity, decided against them by the Circuit Court of Appeals, for the purpose of sustaining the judgment of that court, without applying for a cross-writ of certiorari; but here also the point at issue had been pleaded and argued both in the district court and the Circuit Court of Appeals. The three cases just discussed are not in point.

But *Stelos Co.* v. *Hosiery Corp.* and *United States* v. *American Railway Express Co.* constitute authority supporting respondent's right to urge in this court the affirmance of the judgment of the Circuit Court of Appeals upon a ground which the latter court rejected.

Point V.

THE COMMISSIONER'S CONTENTION THAT THIS CASE SHOULD NOW BE REMANDED TO THE BOARD OF TAX APPEALS, FOR A NEW HEARING AND NEW DETERMINATION WITH RESPECT TO THE APPLICATION OF SECTION 115(G) OF THE REVENUE ACT OF 1928, SHOULD BE OVERRULED.

Section 115(g) of the Revenue Act of 1928 provides that if a corporation cancels or redeems its stock, including stock issued as a stock dividend, at such time and in such manner as to make the distribution and cancellation or redemption essentially equivalent to the distribution of a taxable dividend, the amount so distributed in *redemption or cancellation* (meaning the amount paid out by the corporation in exchange for the shares redeemed) shall be treated as a taxable dividend. The question of whether this section of the statute ought to be applied in the present case, as has already been shown, was raised by the pleadings before the Board and was the one issue covered by the evidence taken and by the stipulation of facts and by the arguments before the Board. A memorandum

opinion was filed by Division 16 of the Board (R. 14-21) on June 29, 1933, whereby it was held (R. 21):

> "The company did not cancel or redeem in the year 1929 preferred stock issued by it as a stock dividend to the petitioners" (meaning the respondent taxpayer and other petitioning taxpayers) "at such time and in such manner as to make the distribution and cancellation in whole or in part essentially equivalent to the distribution of a taxable dividend within the meaning of Section 115(g)." The words "dividend within the" were erroneously omitted from the printed record.

The memeorandum opinion of Division 16 of the Board was the "report" of the Division. Section 601 of the Revenue Act of 1928, amending Section 906(b) of the Revenue Act of 1924, provided that:

> "The report of the division shall become the report of the Board within thirty days after such report by the division, uneless, within such period, the chairman has directed that such report shall be reviewed by the Board."

In the present case, the report of the division became the report of the Board within thirty days after June 29, 1933, because the chairman did not within that time direct that the division's report be reviewed by the Board. On the contrary, review by the Board was denied by order of the chairman dated July 24, 1933 (R. 25).

The commissioner's contention that the report of the division never became a part of the record is untenable. It is in cases where the chairman directs that the report of the division *shall* be reviewed by the Board that the statute makes the report of the division no part of the record. (Section 601 of the Revenue Act of 1928, amending Section 906(b) of the Revenue Act of 1924).

The Commissioner moved for reconsideration, after the filing of the memorandum opinion on June 29, 1933, on the sole ground that the opinion was in conflict with *Tillotson Mfg. Co.* v. *Commissioner,* 27 B. T. A. 913, decided by the

Board on March 11, 1933 (R. 22). The Commissioner's motion did not indicate any dissent from the decision in favor of the taxpayer on the original issue, viz.: whether the taxpayer had had taxable income under Section 115(g) of the statute.

The Board had held in the *Tillotson* case that the distribution of a dividend in common stock to holders of preferred stock produced taxable income. The Commissioner's motion for reconsideration on this ground was denied by order of a member of the Board entered January 15, 1934 (R. 25), and it was this order denying reconsideration that was ultimately reviewed by the Board, and vacated (R. 28). The Board then proceeded to consider the matter further, and decided that even though there was no taxable income resulting from any redemption of stock on October 1, 1929, there was taxable income under the rule of the *Tillotson* case resulting from the taxpayer's receipt of the dividend shares on July 1, 1929 (R. 30-35).

The decision that there was no taxable income under the provisions of Section 115(g) of the statute stands as the decision of the Board and as a part of the record. The Commissioner has never appealed from that decision nor assigned error on it. Article 629 of Regulations 74, dealing with the application of Section 115(g) of the 1928 Act, provided:

> "The question whether a distribution in connection with a cancellation or redemption of stock is essentially equivalent to the distribution of a taxable dividend depends upon the circumstances of each case."

The circumstances of this case were brought out in the evidence taken and the stipulation of facts entered into, upon hearing before the Board. When the Commissioner now argues that the case ought to be remanded to the Board of Tax Appeals, for a further hearing on the question of

the applicability of Section 115(g) of the 1928 Act, he asks in effect for a new trial of a factual issue, but without assignment of any error in the first trial.

The first opinion of the Board in this case was a finding of fact, supported by substantial evidence. The Commissioner never asserted before the Board or before the Circuit Court of Appeals that this finding of fact was *not* supported by evidence. Therefore the finding will not be reviewed or reversed by this court.

> *Helvering* v. *Tex-Penn Oil Co.*, decided by this court March 29, 1937; reported in "Advance Opinions", of Lawyers' Co-Op. Pub. Co., Volume 81, pp. 538-539.

The court will not substitute its judgment on facts for that of the Board. It is the function of the Board to weigh the evidence and declare the result. The Board having done this in the instant case, and having found on sufficient evidence that the taxpayer had no taxable income under the provisions of Section 115(g) of the statute, the result must stand.

> *Elmhurst Cemetery Co.* v. *Commissioner*, decided by this court February 1, 1937; reported in "Advance Opinions" of Lawyers' Co-Op. Pub. Co., Volume 81, p. 300.

In cases of this kind, the function of the Circuit Court of Appeals is to decide whether the correct rule of law was applied to the facts found by the Board, and whether there was substantial evidence before the Board to support the findings made.

> *Helvering* v. *Rankin*, 295 U. S. 123, 131.

Since the issue of a taxable income under Section 115(g) of the statute was not presented to the Circuit Court of

Appeals, it cannot be considered an issue in this court; and the Commissioner's motion for a new trial on that issue should be overruled.

Bank of Arizona v. *Thomas Haverty Co.*, 232 U. S. 106, 110.

Magruder v. *Drury*, 235 U. S. 106, 113.

Ana Maria Sugar Co. v. *Quinones*, 254 U. S. 245, 251.

White River Lumber Co. v. *State ex rel. Applegate*, 279 U. S. 692, 700.

Burnet v. *Commonwealth Imp. Co.*, 287 U. S. 415, 418.

Pacific States Box & Basket Co. v. *White*, 296 U. S. 176, 186.

Helvering v. *Minnesota Tea Co.*, 296 U. S. 378, 380.

Conclusion.

The decision of the Circuit Court of Appeals should be affirmed.

Respectfully submitted,

A. L. Nash,
Attorney for Respondent,
Manitowoc Savings Bank Bldg.,
Manitowoc, Wisconsin.

A. L. Nash,
John C. Altman,
Of Counsel.

October 14, 1937.

APPENDIX.

STATUTES, REGULATIONS AND TREASURY DEPARTMENT DECISIONS INVOLVED.

Revenue Act of 1928, c. 852, 45 Stat. 791:

Sec. 113. *Basis for determining gain or loss.*

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * *

(2) *Gift after December 31, 1920.*—If the property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift. If the facts necessary to determine such basis are unknown to the donee, the Commissioner shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts, the basis shall be the fair market value of such property as found by the Commissioner as of the date or approximate date at which, according to the best information that the Commissioner is able to obtain, such property was acquired by such donor or last preceding owner;

(3) *Transfer in Trust after December 31, 1920.*—If the property was acquired after December 31, 1920, by a transfer in trust (other than by a transfer in trust by a bequest or devise) the basis shall be the same as it would be in the hands of the grantor, increased in the amount of gain or decreased in the amount of loss recognized to the grantor upon such transfer under the law applicable to the year in which the transfer was made;

(4) *Gift or Transfer in Trust Before January 1, 1921.*—If the property was acquired by gift or transfer in trust on or before December 31, 1920, the basis shall be the fair market value of such property at the time

of such acquisition. The provisions of this paragraph shall apply to the acquisition of such property interests as are specified in section 402 (e) of the Revenue Act of 1921, or in section 302 (f) of the Revenue Act of 1924 or the Revenue Act of 1926 (relating to property passing under power of appointment) regardless of the time of acquisition;

(5) *Property Transmitted at Death.*—If personal property was acquired by specific bequest, or if real property was acquired by general or specific devise or by intestacy, the basis shall be the fair market value of the property at the time of the death of the decedent. If the property was acquired by the decedent's estate from the decedent, the basis in the hands of the estate shall be the fair market value of the property at the time of the death of the decedent. In all other cases if the property was acquired either by will or by intestacy, the basis shall be the fair market value of the property at the time of the distribution to the taxpayer. In the case of property transferred in trust to pay the income for life to or upon the order or direction of the grantor, with the right reserved to the grantor at all times prior to his death to revoke the trust, the basis of such property in the hands of the persons entitled under the terms of the trust instrument to the property after the grantor's death shall, after such death, be the same as if the trust instrument had been a will executed on the day of the grantor's death.

Sec. 115. *Distributions by Corporation.*

(a) *Definition of dividends.*—The term "dividend" when used in this title (except in section 203 (a) (4) and section 208 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913.

* * * * *

(f) *Stock dividends.*—A stock dividend shall not be subject to tax.

(g) *Redemption of stock.*—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or

redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend. In the case of the cancellation or redemption of stock not issued as a stock dividend this subsection shall apply only if the cancellation or redemption is made after January 1, 1926.

Sec. 601. *Board of Tax Appeals—Procedure.*

Sections 906 and 907 (a) and (b) of the Revenue Act of 1924, as amended, are further amended to read as follows:

"Sec. 906. (a) The chairman may from time to time divide the Board into divisions of one or more members, assign the members of the Board thereto, and in case of a division of more than one member, designate the chief thereof. If a division, as a result of a vacancy or the absence or inability of a member assigned thereto to serve thereon, is composed of less than the number of members designated for the division, the chairman may assign other members to the division or direct the division to proceed with the transaction of business without awaiting any additional assignment of members thereto. A division shall hear, and make a determination upon, any proceeding instituted before the Board and any motion in connection therewith, assigned to such division by the chairman, and shall make a report of any such determination which constitutes its final disposition of the proceeding.

(b) The report of the division shall become the report of the Board within 30 days after such report by the division, unless within such period the chairman has directed that such report shall be reviewed by the Board. Any preliminary action by a division which does not form the basis for the entry of the final decision shall not be subject to review by the Board except in accordance with such rules as the Board may prescribe. The report of a division shall not be a part of the record in any case in which the chairman directs that such report shall be reviewed by the Board."

* * * * *

Treasury Regulations 74, relating to the Revenue Act of 1928:

Art. 58. *Sale of stock and rights.*—* * * In the case of stock in respect of which any stock divided was paid, the basis for determining gain or loss from a sale of a share of such stock shall be ascertained in accordance with the principles laid down in Article 600. * * *

Art. 600. *Stock or securities distributed in reorganization.*—In the case of stock or securities acquired by a shareholder after December 31, 1923, in connection with a transaction described in section 112(g) and article 576, the basis in the case of the stock in respect of which the distribution was made shall be apportioned between such stock and the stock or securities distributed to the shareholder. The basis for the old and new shares shall be determined in accordance with the following rules:

(1) Where the stock distributed in reorganization is all of substantially the same character or preference as the stock in respect of which the distribution is made, the basis of each share will be the quotient of the cost or other basis of the old shares of stock divided by the total number of the old and new shares.

(2) Where the stock distributed in reorganization is in whole or in part of a character or preference materially different from the stock in respect of which the distribution is made, the cost or other basis of the old shares of stock shall be divided between such old stock and the new stock in proportion, as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock are distributed, and the basis of each share of stock will be the quotient of the cost or other basis of the class with which such share belongs, divided by the number of shares in the class.

* * * * *

Art. 628. *Stock dividends.*—The issuance of its own stock by a corporation as a dividend to its shareholders does not result in taxable income to such shareholders, but gain may be derived or loss sustained by the shareholders from the sale of such stock. The amount of gain derived or loss sustained from the sale of such stock, or from the sale of the stock in respect of which

it is issued, shall be determined as provided in articles 561 and 600.

Treasury Decision 3052, 3 C. B. 38 (August 4, 1920):

"The following applications of the decision of the Supreme Court of the United States in the case of *Eisner* v. *Macomber* in the determination of the taxability of dividends declared by corporation are published for the information and guidance of internal revenue officers and others concerned:

"1. Where a corporation, being authorized so to do by the laws of the State in which it is incorporated, transfers a portion of its surplus to capital account, issues new stock representing the amount of the surplus so transferred, and distributes the stock so issued to its stockholders, such stock is not income to the stockholders, and the stockholders incur no liability for income tax by reason of its receipt".

* * * * *

Treasury Decision 3059, 3 C. B. 38 (August 16, 1920):

"2. Where the stock issued as a dividend is in whole or in part of a character or preference materially different from the stock upon which the stock dividend is paid, the cost, or fair market value as of March 1, 1913, if acquired prior to that date, of the old shares of stock shall be divided between such old stock and the new stock, or classes of new stock, in proportion, as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock are issued, and the cost of each share of stock will be the quotient of the cost of the class to which such share belongs divided by the number of shares in that class."

* * * * *

Office Decision 801, 4 C. B. 24 (January-June, 1921) (extract):

"A stock dividend paid in true preferred stock is exempt from tax the same as though the dividend were paid in common stock".